In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 734

ESTATE OF MERVIN G. PIERPONT, DECEASED, UNION TRUST COMPANY OF MARYLAND AND ERNEST L. POYNER, EXECUTIVES, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE COMMISSIONER

The underlying question in this litigation is whether a bequest in trust to Lallah R. Pierpont, widow of the deceased, qualifies for the marital deduction under the federal estate tax. The only dispute between the parties is whether the power given in the will to appoint the trust property "in such manner and proportions as my said wife may designate and appoint in her Last Will and Testament" was exercisable in favor of the estate of the surviving spouse as required by Section 2056(b)(5) of the Internal Revenue Code of 1954. It is agreed that the scope of the power must be determined under Maryland law.

After the estate tax return had been filed, the widow, trustees, and executors brought an action for declaratory judgment in the Circuit Court of Baltimore City asking for a decree that the widow had the right to appoint the corpus of the trust to her estate. Decedent's son and daughter-in-law, their children and descendants, and a Masonic fraternal organization, alternative beneficiaries of another trust to which the property was to go in default of appointment, were named as respondents. The son and the daughter-in-law neither filed an answer nor appeared. The guardian *ad litem* for the children and descendants answered but took no position on the question, and the Masonic Order consented to the relief prayed for. The Baltimore court entered a decree *pro confesso* and referred the matter to an examiner-master who, after hearing testimony solely from an officer of petitioner trust company, filed a report incorporating verbatim the memorandum of law submitted by petitioner's counsel and a proposed decree granting the prayer, which was signed by the court. No appeal was taken from the decree.

Both the Tax Court and the Court of Appeals held that they were not bound by the Baltimore court's decree and made an independent examination of Maryland law. Both concluded that under the law of Maryland, as applied in decisions of the highest court of Maryland (starting with *Balls* v. *Dampman*, 69 Md. 390, 16 Atl. 16 (1888)), the Court of Appeals for the Fourth Circuit (*Leser* v. *Burnet*, 46 F. 2d 756), and the Tax Court (*Estate of William C. Allen*, 29 T.C. 465), the donee of a power could not appoint to his estate unless expressly authorized by the governing

instrument. Accordingly, the bequest was held not to qualify for the marital deduction.

This Court is asked to review the question whether the decision of the Baltimore City Court precluded the courts below from making their own determination of Maryland law.

Where federal tax liabilities turn on state law, the problem of the effect to be given state court determinations has been a recurring and vexing one. Once a state court finally decrees that Blackacre belongs to *A* rather than *B*, the Federal Government can no longer tax the income to *B* on grounds of ownership however insubstantial *A*'s claim to the property may have been. But it does not necessarily follow that *B* can rely on the *ground* on which the state court decision was based to avoid tax on the income prior to the decree, if he actually enjoyed the income or could have enjoyed it by raising his voice. A distinction must be made between the operative effect of the state court decree vesting title in *A* and the grounds for its decision. If *B* acquiesced in the state court proceedings in order to make a gift (or pay a salary) to *A*, the state court had little choice but to decree *A*'s ownership; but that should not preclude the Federal Government from attaching the proper tax consequences to the true nature of the transaction.

These problems become particularly acute in federal estate tax controversies where the important question is apt to be not who has the property but how did he get it. For example, under the marital deduction the property must pass directly from the decedent and not through actions by other beneficiaries. Cf. Sec-

tion 2056(d). If a will gives only a life estate to the widow and the remaindermen stand idly by while the probate court awards her a fee interest, the decree will be determinative as to future title; but the purported finding that it came from the deceased husband should not bind the taxing authorities. See *Faulkerson's Estate* v. *United States,* 301 F. 2d 231 (C.A. 7th), certiorari denied, 371 U.S. 887.

It should also be noted that Congress has made estate tax issues turn on the existence of powers and limitations that may have little practical effect, especially where the beneficiaries enjoy a family community of interest. In other cases, all private parties may be demonstrably better off if the federal tax can be saved. The courts below found both elements in the instant case. State court decrees in such circumstances are not determinations of true controversies no matter how many trappings of a contest may be added. To give finality to such state court decrees would be to foster post-mortem estate planning and to favor residents of states with lenient probate practices.

Thus we believe the decision below is correct and is in accord with the decisions of this Court and of most courts of appeals, despite some diversity in the grounds stated for looking beyond state court decrees. The facts of this case bring it squarely within this Court's test set forth in *Freuler* v. *Helvering,* 291 U.S. 35, 45 (1934): "collusive in the sense that all the parties joined in a submission of the issues and sought a decision which would adversely affect the

Government's right to additional * * * tax."[1] As the Court of Appeals observed, its application of *Freuler* to permit reexamination is consistent with the recent holdings of the Seventh Circuit in *Faulkerson's Estate* v. *Commissioner, supra,* and the Eighth Circuit in *Estate of Peyton* v. *Commissioner,* 323 F. 2d 438. See also *McHarg* v. *Fitzpatrick,* 45 Am. Fed. Tax R. 1028, 1033 (D.C. Conn. 1953), affirmed, 210 F. 2d 792 (C.A. 2d); *Stallworth's Estate* v. *Commissioner,* 260 F. 2d 760, 763 (C.A. 5th); *Flitcroft* v. *Commissioner,* 328 F. 2d 449, 457–458 (C.A. 9th); *In re Sweet's Estate,* 234 F. 2d 401, 404 (C.A. 10th), certiorari denied, 352 U.S. 878; cf. *Channing* v. *Hassett,* 200 F. 2d 514 (C.A. 1st).

We agree, however, with petitioner's view (Pet. 15) that the decision below cannot be reconciled with the approach of the Third Circuit which apparently requires collusion in the nature of fraud on any issue actually decided by the state court before it will make its own examination of state law. *Gallagher* v. *Smith,* 223 F. 2d 218; *Babcock's Estate* v. *Commissioner,* 234

[1] It is true that in *Blair* v. *Commissioner,* 300 U.S. 5, 10, this Court did state that an intermediate state appellate court decree was binding as to the validity of certain assignments. However, that conclusion was reached only after a determination that the suit actually settled rights between the parties and was not collusive within the *Freuler* test. It also emphasized that the intermediate appellate court had reached a "deliberate" conclusion. Since the same result would not necessarily have been reached had some of these elements been lacking, we do not read the case as holding that appellate court decisions may never be inquired into. However, nonadversary cases are much less likely to get into the appellate courts, and once there are more apt to be decided on the merits; occasions for reexamining such decisions will thus be much less frequent than those of *nisi prius* courts.

F. 2d 837, 841–842; *Beecher* v. *United States*, 280 F. 2d 202, 203–204; *Darlington's Estate* v. *Commissioner*, 302 F. 2d 693, 694–695. While none of the Third Circuit decisions deal with state court determinations as to the extent of a testamentary power as in the instant case, we believe a sufficient conflict exists to make review appropriate.

Since the question on which these courts are in conflict is now pending in four cases in three Courts of Appeals [2] and is one of long-standing and continuing importance,[3] we do not oppose the issuance of a writ of certiorari.

Respectfully submitted.

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[2] *Second National Bank of New Haven* v. *United States* and *McIntosh* v. *United States* in the Second Circuit; *Farish* v. *United States* in the Fifth Circuit; and *Old Kent Bank & Trust Co.* v. *United States* in the Sixth Circuit.

[3] The Seventh Circuit in *Merchants National Bank & Trust Co.* v. *United States*, 246 F. 2d 410 (1957) expressly recognized the existence of "a number of seemingly conflicting federal courts of appeals cases" and set forth 24 cases seemingly in conflict (p. 417, n. 12). In *Second National Bank of New Haven* v. *United States*, 222 F. Supp. 446, 456–457 (D. Conn.), now pending upon appeal in the Second Circuit, the court cited 32 federal tax cases in the Courts of Appeals and in the District Courts involving this question which are in apparent conflict with each other.

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